Independence Avenue SW., Washington, DC 20591; telephone: (202) 426–8686.

SUPPLEMENTARY INFORMATION:

History

On February 24, 1986, the FAA proposed to amend Parts 71 and 75 of the Federal Aviation Regulations (14 CFR Parts 71 and 75) to establish a new Federal Airway V–308 and Jet Route J–188 between Bethel and Sparrevohn, AK (51 FR 6419). The additional Federal Airway and Jet Route expedite traffic and reduce sector workload by providing an alternate route for aircraft departing Bethel and climbing eastbound. This action alleviates opposite direction climb situations. Interested parties were invited to participate in this rulemaking proceeding by submitting written comments on the proposal to the FAA. No comments objecting to the proposal were received. Except for editorial changes, these amendments are the same as those proposed in the notice. Sections 71.125 and 75.100 of Parts 71 and 75 of the Federal Aviation Regulations were republished in Handbook 7400.6B dated January 2, 1986.

The Rule

These amendments to Parts 71 and 75 of the Federal Aviation Regulations establish new VOR Federal Airway V–308 and Jet Route J–188 between Bethel and Sparrevohn, AK. The new Jet Route and the new VOR Federal Airway expedite traffic and reduce workload by providing additional flexibility for maneuvering traffic in the terminal area.

The FAA has determined that this regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It, therefore—(1) is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this rule will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

List of Subjects in 14 CFR Parts 71 and 75

Aviation safety, VOR Federal airways and Jet Routes.

Adoption of the Amendments

Accordingly, pursuant to the authority delegated to me, Parts 71 and 75 of the Federal Aviation Regulations (14 CFR Parts 71 and 75) are amended, as follows:

PART 71—[AMENDED]

1. The authority citation for Part 71 continues to read as follows:

Authority: 49 U.S.C. 1348(a), 1354(a), 1510; Executive Order 10854; 49 U.S.C. 106(g) (Revised Pub. L. 97–449, January 12, 1983); 14 CFR 11.69.

§ 71.125 [Amended]

2. Section 71.125 is amended as follows:

V–308 [New]

From Bethel, AK, via INT Bethel 066 ° and Sparrevohn, AK, 279 ° radials; to Sparrevohn.

PART 75—[AMENDED]

3. The authority citation for Part 75 continues to read as follows:

Authority: 49 U.S.C. 1348(a), 1354(a), 1510; Executive Order 10854; 49 U.S.C. 106(g) (Revised Pub. L. 97–449, January 12, 1983); 14 CFR 11.69.

§ 75.100 [Amended]

4. Section 75.100 is amended as follows:

J–188 [New]

From Bethel, AK, via INT Bethel 066 ° and Sparrevohn, AK, 279 ° radials; to Sparrevohn.

Issued in Washington, DC, on May 6, 1986.

Daniel J. Peterson,

Manager, Airspace-Rules and Aeronautical Information Division.

[FR Doc. 86–10646 Filed 5–12–86; 8:45 am]

BILLING CODE 4910–13–M

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 5, 16 and 33

Domestic Exchange-Traded Commodity Options; Revisions to Rules for Trading Non-Agricultural Option Contracts and Termination of Pilot Program Status

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rulemaking.

SUMMARY: In late 1981 the Commission published final rules governing a three-year pilot program for exchange-traded commodity options. Option trading began on October 1, 1982 following the designation of the first option contract markets. That three-year pilot program expired on October 1, 1985. The Commission has examined its experience under the pilot program and has re-evaluated various option rules. The Commission is hereby adopting various amendments to the rules governing option trading, terminating the pilot status of this program, and making permanent the status of such trading.

EFFECTIVE DATE: With the exception of the amendments to Part 16 which shall be effective September 10, 1986, these amendments will become effective upon the expiration of thirty calendar days of continuous session of the Congress after the transmittal of these rules and related materials to the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition, and Forestry pursuant to section 4c(c) of the Commodity Exchange Act, but not before further notice of the effective date is published in the Federal Register.

FOR FURTHER INFORMATION CONTACT: Paul M. Architzel, Chief Counsel, Division of Economic Analysis, or Kenneth M. Rosenzweig, Associate Director, Division of Trading and Markets, 2033 K Street, NW., Washington, DC 20581, (202) 254–6990 or 254–8955, respectively.

SUPPLEMENTARY INFORMATION:

I. Background

As the culmination of a long history of Commission efforts to provide for the trading of commodity options in a regulated environment, the Commission, on November 3, 1981, published final rules establishing a strictly controlled, three-year pilot program to permit exchange-traded commodity options. 46 FR 54500. This pilot program permitted the re-introduction of option trading in the United States. Previously, exchange trading of options on the domestic agricultural commodities regulated under the Commodity Exchange Act ("Act") were prohibited by Congress in 1936 as a result of excessive price movements and severe disruptions in the futures markets attributed to speculative trading in options.[1] Moreover, prior to this pilot program, in 1978, the Commission, with minor exceptions, had banned all option trading in the previously unregulated commodities in the United States. This ban was the result of significant

[1] Act of June 15, 1936, Ch. 545, Section 5, 49 Stat. 1484. *See, e.g.*, Hearings on H.R. 8829 Before the House Committee on Agriculture, 73rd Cong., 2d Sess. 10 (1934) (statement of J. M. Mehl, Assistant Chief, Grain Futures Administration, United States Department of Agriculture); 80 Cong. Rec. 7853–54 (1936) (remarks of Senator Pope).

difficulties associated with the trading of such commodity options.

In the late 1960's and early 1970's, massive frauds in the off-exchange offer and sale of options on those commodities not regulated under the Act occurred. Those frauds were part of the impetus behind the creation of the Commission. In response, the Congress granted the new Commission broad power over option transactions in the previously unregulated commodities.[2] Because of continued abuses in the offer and sale of options not traded on domestic boards of trade, the Commission suspended the offer and sale of all commodity options in the United States effective June 1, 1978. 43 FR 16153 (April 17, 1978). The Congress codified that suspension as part of the 1978 amendments to the Act but granted the Commission authority to establish a pilot program to permit the trading of commodity options on exchanges. Pub. L. No. 95–405, section 3, 92 Stat. 867; 7 U.S.C. 6c(c) (1976, Supp. V).

The Commission reasoned that in light of these prior abuses in option trading greater protections for public customers were needed. The Commission believed that these protections could be provided if the trading of options took place on regulated exchanges. Accordingly, the pilot program for exchange-traded options was based:

> On the assumption of direct and primary regulatory responsibilities by the contract markets for the participation of their members firms. Indeed, the pilot program places significantly greater self-regulatory duties and responsibilities on boards of trade than is presently the case for futures trading, particularly with respect to the protection of the public from sales practice abuses. . . . It is only by placing these regulatory responsibilities on the exchanges that the Commission believes it can presently ensure that sufficient regulatory resources will be deployed to prevent a recurrence of the abuses which have characterized commodity options in the past.
>
> 46 FR at 54502.

The Commission is of the opinion that its pilot program for exchange-traded commodity options has been a success. This is highlighted by the Commission's phased expansion of option trading over the course of the pilot program. In this regard, the initial option rules permitted one option on a commodity futures contract other than on a domestic agricultural commodity to be traded on each exchange. 46 FR at 54530. Subsequently, the Commission adopted rules also permitting the trading of one option per exchange on a physical commodity. 47 FR 56996 (December 22, 1982). The pilot program was then modified by permitting two options per exchange whether on futures or physicals. 48 FR 41575 (September 16, 1983). On August 24, 1984, the permitted number of options on futures contracts was expanded from two to five options per exchange, although the previous limit on the number of options on a physical commodity was retained. 49 FR 33641. Finally, on November 4, 1985, the Commission expanded the number of options permitted on each exchange from five to eight. 50 FR 48511. In addition, following the repeal by the Congress of the 1936 statutory ban on options involving domestic agricultural commodities, a separate three-year pilot program for the trading of options on those commodity futures contracts was adopted on January 23, 1984. 49 FR 2752. This pilot program provided that each exchange could be designated for two options on domestic agricultural futures contracts. On April 2, 1986, the Commission determined to expand this latter pilot program from two to five commodity options per exchange. 51 FR 11905 (April 8, 1986).

Pursuant to the requirements of Section 4c(c) of the Act, with each major expansion of the program the Commission has justified to the Congress its ability to regulate the trading of exchange-traded commodity options. Major interim evaluations of the pilot option programs were made at the time the non-agricultural option pilot program was expanded from one option on a futures contract and one on a physical contract per exchange to two options of any kind, when the program was expanded from two to five options per exchange, and at the time the pilot program for options on domestic agricultural futures contracts was initiated. In addition, a major evaluation of the Commission's experience with option trading was sent to the Congress at the time that the pilot program for domestic agricultural options was expanded from two to five contracts per exchange.

Overall, The Commission's experience with its pilot option programs has been that few regulatory problems have arisen and that, for the most part, the exchanges have discharged their responsibilities under the programs adequately. Moreover, there were few, if any, customer complaints of the type which formerly had characterized option trading. Finally, the Commission has noticed no adverse effects on the underlying futures markets resulting from the option programs. An exception to the overall success of the option program on non-agricultural commodities has been the March 1985 default of Volume Investors Corporation, a clearing member of the Comex Clearing Association, as a result of the failure of three of its customers to meet margin calls on their uncovered short option positions in the Comex gold option contract. In response to this problem, the Commission proposed separate capital rules and a guideline concerning option margins.[3] 50 FR 3162; 50 FR 31625 (August 5, 1985). The Commission is still considering those proposed rules and the comments received on them and will make an appropriate determination at some future date.

II. The Proposed Rules

As part of its final evaluation of the pilot option program, the Commission proposed several modificaitons to the existing option rules. 50 FR 35247 (August 30, 1985). The most fundamental change contemplated by the Commission was whether to make the option program permanent. The Commission requested comment on whether, as an alternative to this, the pilot status of the program should be maintained but the permitted number of options expanded. In addition, changes in the existing rules which were proposed included modifications to the current definition of hedging to cover options, deleting the requirement of participation by commercial interests in developing option contracts, deleting an exchange-required definition of deep-out-of-the-money options, raising the underlying futures volume criterion for initial designation, establishing delisting criteria based on the volume in the underlying futures and in the option contracts, modifying reporting requirements and certain disclosure rules, deleting the requirement for exchange conduct of market-wide

[2] Commodity Futures Trading Commission Act of 1974, Pub. L. 93-463, Section 402(c), 88 Stat. 1412–13 (codified at 7 U.S.C. 6c(b)). *See, e.g.*, 120 Cong. Rec. S34997 (daily ed. October 10, 1974) (remarks of Senator Talmadge); Hearings on the Review of the Commodity Exchange Act Before the House Committee on Agriculture, 93rd Cong., 1st Sess. 11 (1973) (statement of Representative Smith); H.R. Rep. No. 93–975, 93rd Cong., 2d Sess. 37–39, 48–50 (1974).

[3] The Commission notes that some of the exchanges commenting on the option rule proposals suggested that the Commission modify its regulations to permit "futures-style" margining of option transactions. The Commission has explored this issue in the past. *See, e.g.*, 49 FR 8937 (March 9, 1984). The Commission is not presently inclined, however, to expend substantial additional resources on any further examination of this subject, at least until a unified proposal, reasonably representative of the interests of the various exchanges and the clearing organizations, futures commission merchants, commercial users of the option markets and other interested persons, is presented to the Commission.

surveys, and modifying the requirement to file promotional material, customer complaints, and disciplinary actions with the exchanges.[4]

III. Comments Received

In response to these proposed rules the Commission received twenty-one comments. The commenters included six exchanges, eight futures commission merchants or commodity trading advisors, several foreign exchanges, one industry association, the government of the United Kingdom, and several corporate users of the option markets. In general, all of the commenters agreed that the pilot option program had been a success and should be made permanent.

The commenters agreed that option trading served a useful economic function and provided trading opportunities additional to future trading. Accordingly, the commenters supported the growth of the option program. Moreover, none of the commenters disagreed that certain of the Commission's proposed regulations should be adopted as final. These included the proposal to include options within the meaning of hedging (Commission Rule 1.3(z)), to delete the requirement that commercials participate in contract design (Commission Rule 33.4(a)(5)(ii)), to delete the required exchange definition of "deep-out-of-the-money" options (Commission Rule 33.4(b)(2)), and to delete the requirement that contract markets conduct market-wide surveys (Commission Rule 16.05).

In response to the Commission's request, several commenters also suggested various rule changes. These included proposals that contract terms and conditions be standardized, that the time between expiration of the option and the underlying futures contract be reduced from ten days to one day (Commission Rule 33.4(d)(1)), that the economic purpose test for option designation be deleted (Commission Rule 33.4(a)(5)(i)), that the requirement for speculative position limits on options be deleted or revised (Commission Rule 1.61), that an exchange be able to trade an option on any underlying futures contract regardless of where that contract is traded (Commission Rule 33.4(a)(3)), and that the ban on foreign traded options be lifted. These issues are discussed in greater detail below.

IV. Final Rules

A. The Pilot Nature of the Program

In light of the favorable experience with the pilot option program, including the apparent substantial use of these markets by commercial enterprises, the Commission requested comment on whether the pilot program should be made permanent and whether the Commission should lift the limitation on the number of options on futures contracts on commodities other than domestic agricultural commodities permitted on each exchange. Currently, Commission Rule 33.5(c) provides that the effective period for designation for commodity options shall not exceed three years from the effective date of designation. In addition, Commission Rule 33.4(a)(6) limits the number of commodity options which may be traded on an exchange.

As noted above, all twenty-one commenters responded favorably to this proposal. They uniformly held the option that the option program had been a success and should be made permanent. Moreover, they agreed that the limitation on the number of options permitted per exchange should be lifted. The Commission concurs. Accordingly, the Commission is amending Rules 33.4(a)(6) and 33.5(c) to delete the three-year limitation on the period of designation and the limitation on the number of options permitted per exchange. Insofar as these provisions also relate to the trading of options on physicals, however, it should be noted that although the three-year period for designation of such options has been lifted, the numeric limit on the number of such options continues. This limitation will be reconsidered after greater experience with the trading of options on physical commodities has been obtained.

B. Definition of Bona Fide Hedging

The Commission proposed that options be included within the definition of hedging under Commission Rule 1.3(z). As noted when the Commission proposed this rule,

> At the time that the initial option rules were adopted, the Commission was concerned that the use of options to shift risk might not fit fully with the definition of "hedging" as it applied to futures contracts.
>
> 50 FR 35249.

However, the Commission has learned in the course of the pilot program that the application of the term "hedging" to certain risk shifting activities of option traders is appropriate. Evidence of this is found in certain applications by the exchanges of the term "hedging" and the reference to the Commission's definition of hedging in Commission Rule 1.3(z)(1) as part of exchange-set speculative position limits for options. Moreover, uniform use of the term hedging with respect to both options and futures trading would simplify the option rules. The Commission therefore believes that an amendment of Commission Rule 1.3(z)(1) is appropriate. In this connection, Commission Rules 1.46 and 1.61 are also being amended in order to be consistent with the change to Commission Rule 1.3(z)(1).[5]

Although the adoption of this and the related proposed rules as final was supported by all of the commenters, one commenter questioned the Commission's statement "that generally option grantors cannot meet the Commission's definition of hedging and that this proposed amendment is not intended to imply that covering speculative futures . . . with options . . . can be considered hedging. . . ." 50 FR 35249. That commenter maintained that "it is incorrect to say that the use of options on financial futures to hedge a securities portfolio will generally not meet the definition of hedging."

The Commission reiterates, as discussed in the notice of proposed rulemaking, that the specific enumerated examples found in Commission rule 1.3(z)(2) apply only to those futures contracts governed by direct federal speculative limits. As further noted in that **Federal Register** notice, whether particular types of option transactions should be classified as hedging must be determined by applying only the general definition contained in Commission Rule 1.3(z)(1). Accordingly, although option grantors generally cannot meet the Commission's definition of hedging and the covering of speculative futures (or option) positions with option (or futures) positions cannot be considered hedging, there may be certain instances where grantors may be *bona fide* hedgers.

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[4] The Commission also proposed to amend the financial early warning system applicable to futures commission merchants by extending the requirements of Commission regulation 1.12 to situations in which a margin call to an individual account (or group of related accounts) exceeded an FCM's excess adjusted net capital. As the Commission explained at the time, its proposal was intended to augment other rule amendments, margin guidelines, and related requirements that had been published in response to the failure of Volume Investors Corporation. 50 FR at 35253–54. The Commission is continuing to evaluate each of these proposals and has extended the comment period on the proposed amendments to the Commission's minimum financial and related requirements that were first proposed in August 1985. *See* 51 FR 7285 (March 3, 1986). The Commission believes that its proposed enhancement of the financial early warning system is best considered in conjunction with those other financial rule proposals and is not, therefore, taking any action at this time on that aspect of this rulemaking proceeding.

[5] The Commission is also adopting a technical amendment to Commission Rule 1.61 deleting from that rule provisions for a phase-in period. These provisions are no longer needed.

C. Designation Criteria

Several amendments were proposed to Commission Rule 33.4 to amend the requirements for contract market designation. The Commission proposed these modifications in light of its three years of experience with the option program. In general, the modifications being adopted simplify designation requirements. Other modifications, such as raising the initial volume of the underlying futures market required for the designation of an option market, follow from the ending of the pilot status of the program and the deletion of other limitations or designation criteria.

1. Participation of Commercial Interests.

The Commission, as proposed, is deleting the requirement of Commission Rule 33.4(a)(5)(ii) that an exchange applying for designation demonstrate that commercial interests participated in formulating the option contract. Although this requirement was necessary initially in light of general inexperience with commodity option trading when the pilot program began, exchanges currently have sufficient expertise to make such a provision unnecessary. This view was concurred in by both the exchange and commercial commenters.

2. Deep Out-of-the-Money Options.

The Commission also proposed to delete the requirement that exchanges have rules which specifically identify and govern deep-out-of-the-money options. Commission Rule 33.4(d)(2).[6] The Commission's proposal, however, did not affect the existing requirement that the contract markets, as part of their sales practice audits, ascertain whether the offer or sale by futures commission merchants (FCMs) of such deep-out-of-the-money options is consistent with exchange rules. Commission Rule 33.4(c). Moreover, the Options Disclosure Statement that must be provided to every prospective option customer details the risks associated with both the purchase and the sale of deep-out-of-the-money options. Commission Rule 33.7(b)(6).

Although all of those commenting supported the proposed deletion of Commission Rule 33.4(b)(2), one commenter argued that deletion of only this rule did not go far enough. It maintained that the Commission has "never made a credible case for regulating the purchase or sale of options that are deep out of the money." Accordingly, the commenter opposed the requirement that boards of trade look for such trading as part of the sale practice audits that they conduct. Moreover, the commenter objected to this requirement on the grounds that what constitutes a deep-out-of-the-money option has been ill-defined.

As the Commission stated in its proposed rulemaking, the Commission maintains its belief that the offer and sale of such options must be carefully monitored because of the financial risks and issues concerning customer protection raised by such options. A pattern of such sales can indeed be abusive as well as a financial risk in light of the low-premiums and potential risk involved. As explained by the Commission in proposing to delete Commission Rule 33.4(b)(2), these issues are expected to be addressed by net capital and other financial rules and by greater emphasis on sales practice audits. Accordingly, the Commission emphasizes that although definitions of deep-out-of-the-money options will no longer be required because such general rules tended to be less encompassing than appropriate in particular cases, a case-by-case evaluation of specific options series in conjunction with front office audits remains a requirement of the exchange sales practice audits, even in the absence of rules specifically identifying which options would be deemed to be deep-out-of-the-money for a particular contract. Thus, a pattern of such trading in options with low premiums and strike prices considerably away from the money should be considered and treated as an abusive sales practice. Accordingly, the existing requirements in Commission Rule 33.4(c) that the exchanges' sales practice audit programs include provisions for the review of member FCM sales of deep-out-of-the-money options remain effective despite the elimination of the requirement that deep-out-of-the-money options be defined by exchange rules. Despite the elimination of this requirement, exchanges are free to retain their rules concerning the definition of deep-outs or to propose ones that the exchange would consider of greater use in carrying out their sales audit programs.

3. Volume of the Underlying Futures Market Required for Designation.

The Commission proposed to raise the threshold volume level of the underlying futures contract for designation of an option on such a futures contract from the current level of 1,000 contracts per week to 3,000 contracts per week and to eliminate the current alternative non-numeric test. The Commission reasoned that an initial volume of 1,000 contracts per week generally may not be adequate to ensure that a trader would be able to exercise an option into a sufficiently liquid market so that the resulting position could be offset without suffering a substantial loss of the option's true economic value.

Commenters were generally opposed to this proposal. The tenor of those commenting on the proposal was that the Commission lacked an empirical basis for its determination to raise the volume requirement on the underlying futures contract for designation of an option. One commenter expressed the view that "the Commission has no evidence at all that permits it to make a judgement either way. In the absence of any evidence, the Commission is basing its regulations on speculation rather than fact." The commenter continued that low volume in a futures contract is not by itself evidence that the market is illiquid.

The Commission noted in its proposed rulemaking that upon reviewing the data for trading volume of all designated option contract markets, it found that all of the option markets had average volumes in the underlying futures market far in excess of the 1,000 contract per week level. Indeed, all except one of the designated contracts had average volumes at least in the range of 5,000 contracts per week. 50 FR 35250. Moreover, it appeared from the Commission's data that the 3,000 contract level separates low volume futures contracts from the higher volume contracts comparable to those now included in the pilot program.

Based on such trading experience in the pilot program, the 3,000 contract weekly level was found to be the most appropriate to ensure that options are designated only on those relatively active futures markets which will not be adversely affected by option trading. This requirement takes on added importance in light of the Commission's determination to remove the current limitation on the number of contracts permitted per exchange. A higher volume level is necessary to ensure that options will be traded only on those

[6] Deep-out-of-the-money optios are options in which the strike prices are significantly above, in the case of a call, or significantly below, in the case of a put, the current price of the underlying futures contract of physical commodity. Characteristically, the premium for these options is relatively inexpensive while the likelihood of such options' becoming profitable is remote. Nevertheless grantors of such options may face substantial liability if there are sudden, adverse movements in the price of the underlying commodity.

contract markets which can best support such a derivative market.

Several commenters objected to the Commission's proposed deletion of the alternative designation criterion of Commission Rule 33.4(a) (5) (iii), which permitted designation upon a demonstration that there is sufficient liquidity in the cash and futures markets to prevent the disruption of those markets. The Commission maintained that the alternative test should be deleted because it did not ensure that a futures market was sufficiently liquid to avoid adverse effects from option trading. The commeters contended that the alternative test was needed to provide flexibility for designation of options on newly designated futues markets. Thus, one commenter stated that:

> We believe that cases will be seen where the introduction of an option will enhance the trading volume of the underlying future to the point where the underlying futures contract easily fits within the proposed criteria. We recognize the Commission's continuing concern with manipulation in low volume situations. Despite this we believe that the economic benefits which may be gained from the low volume situation outweigh the inherent risks of manipulation that is believed to be present.

The Commission agrees that adherence to the objective test, which requires a year-long history of trading, could result in a needless delay in the introdution of option markets on newly designated contracts. That is not to say, however, that the Commission will at any time permit the simultaneous designation of a futures contract and option on a futures market with the expectation that the introduction of the two contracts at the same time will assure adequate liquidity. The designation of the derivative option market must be predicated upon a pre-existing, liquid underlying futures market.

Upon careful consideration of the comments, the experience with the pilot program and the intent of the proposal, the Commission is maintaining in Rule 33.4(a)(5)(iii) an alternative liquidity demonstration. This demonstration requires a showing that a futures market substantially meets the objective volume criterion in less than a year. The Commission expects that this provision will be most useful in instances where a newly introduced futures contract or an existing one which begins to exhibit higher volume than in the past, trades above the 3,000 contract a week level, substantially meeting the required volume level in less than a year. Under this test, the higher the trading volumes the less time would be needed to demonstrate a liquid market, but in no event could the test be met until there has been some history concerning deliveries on the contract. The Commission believes that this provision maintains the flexibility sought by the commenters while addressing the Commission's concerns that the applicable test be related to the liquidity of the underlying futures market.

4. Additional Suggested Modifications to Designation Criteria

Several of the proposals advanced by commenters involve changes to the criteria for designation. One industry association advocated the need for uniformity and standardization in contract terms and conditions as they relate to trading mechanics. This would include standardization of expiration dates, margin requirements and exercise procedures. The commenter stated that such uniform terms and conditions would improve customer understanding and increase option usage. Although such uniformity in trading mechanics might be beneficial to some market participants, the Commission believes that as a matter of regulatory policy it should not require such uniformity. Further, exchanges may have developed differences in trading mechanics in response to differences in the mechanics of their futures trading. Accordingly, the Commission does not believe that it should require such uniformity where it is unnecessary to ensure the economic appropriateness of the option contract or to protect the public.

An exchange suggested that Commisson Rule 33.4(d)(1) be deleted or amended to provide that an option expire one day, rather than the presently required ten days, before first notice day for delivery on the futures contract. The commenter suggested that the Commission's examination of this issue in granting exemptions from the current ten-day provision indicates that a shorter time period between expiration of the futures and delivery on the futures "would enhance the benefits of option trading by capturing a higher degree of convergence between cash and futures prices which occur closer to delivery period." The commenter continued that, because futures position limits apply to all positions created by option exercise, the expiration of the option in a period of less than ten days before delivery on the future would not pose serious disruption problems to futures contracts which involve physical delivery. The commenter further opined that in the case of cash-settled futures contracts, no such buffer period would be necessary.

The Commission does not agree that the rule should be changed. The Commission believes that having a one-day buffer period between the option expiration and first notice day could lead to congestion in the liquidation of many futures contracts. This is true not only for physical delivery contracts. Accordingly, the Commission believes that continuation of the present ten-day buffer period is appropriate. As in the past, however, exchanges are free to demonstrate on a case-by-case basis why less than the stated period is more appropriate. Although this may be viewed as a more cautious approach than advocated by the commenter, the Commission must be assured that trading on a derivative market will not create congestion or interfere with deliveries on the primary market.

Several commenters stated their belief that any exchange should be allowed to trade an option on any futures contract regardless of where the underlying futures contract is traded. After careful consideration of this comment, the Commission believes such a proposal would seriously undermine the success of the option program. From its beginning, the option program has relied on exchange self-regulation. The ability of exchanges to provide for the orderly trading of both futures and options could be seriously undermined were the same exchange not charged with responsibility for regulating both the underlying futures market and its option market. Accordingly, the Commission is not amending the current requirement under Commission Rule 33.4(a)(3) that the option and its underlying futures contract be traded on the same board of trade.

Other commenters contended that the economic purpose test and speculative position limits were unnecessary for options, placing additional restrictions on futures-related option markets which put them at a competitive disadvantage to security-related option markets. While the regulatory structures for option trading in the futures and securities arenas are not identical, the Commission believes that both of these features of its option regulatory structure should be maintained. As a commenter noted, the economic purpose of the typical option is clear-cut since a related futures contract already has demonstrated such a purpose. Thus, the demonstration of an economic purpose for a particular futures-based option should be relatively easy to make. Accordingly, because the burden of that demonstration generally will not be substantial, the Commission believes that the requirement should be maintained. On an option on a physcal commodity, however, no previous

demonstration of an economic purpose will have been made. Thus, although the burden of demonstrating that the proposed instrument will serve an economic purpose may therefore be greater, this requirement maintains the consistency between futures and option regulation.

With respect to speculative position limits, the Commission notes that such limits are a standard regulatory feature of both securities and commodity option trading. The Commission believes that exchange-set speculative position limits pursuant to Commission Rule 1.61 continue to serve an important regulatory function in commodity option markets. As the Commission noted previously:

> Although large options positions may not have precisely the same potentially disruptive effect as large futures positions, the relationship between the options market and the futures market strongly suggests that the effect of unlimited trading in one market can pass through to the other market either directly through exercise or indirectly through arbitrage.

46 FR 50938, 50944 (October 16, 1981) Accordingly, the Commission believes that Commission Rule 1.61 should not be amended at this time.

Finally, three commenters requested that the Commission lift its ban on foreign-traded options. In this respect the Commission notes that it has recently proposed rules concerning foreign options and futures (51 FR 12104 (April 8, 1986)). It will consider the trading of foreign options in that context and will consider the comments filed in this rulemaking proceeding at that time.[7]

D. Delisting Criteria

As part of the rules making option trading permanent, the Commission proposed delisting criteria to halt trading in any option on a futures contract where the futures contract fails to maintain the requisite volume level and for any option market that itself fails to trade over a specified volume for a specified period of time. Although such requirements were unnecessary during the pilot program, when trading is made permanent it can be expected that over time the volume of trading in various markets may fluctuate greatly.

Accordingly, the Commission proposed, and is now adopting, Rule 5.4 which requires that where the total trading volume for all trading months in the underlying future falls below an average of 1,000 contracts per week for the preceding six months, no new option expirations may be listed for trading. However, it would be expected that as prices of the underlying futures or physical commodity fluctuate substantially, at least some new strike prices would be added, as specified in exchange rules, to the remaining expirations as they trade out. Where the listing of additional option expirations has been suspended, additional expirations could be added only when trading volume in the underlying futures contract rose above an average of 2,000 contracts per week for a period of three months. These volume criteria should be computed by averaging together the total weekly volumes over the three or six-month period, as appropriate.

As explained in the notice of proposed rulemaking, the 1,000 contract per week level is the current designation requirement and, in the Commission's opinion, is the minimum acceptable level below which the individual trader in the underlying futures market may be adversely affected by the existence of a derivative market. 50 FR 3250–3251. As further explained in the proposal, a higher initial designation volume level and level needed to resume trading once the delisting mechanism has been activated are designed to avoid unduly disrupting markets based on minor volume fluctuations; such higher volume levels are set to detect generalized trends in trading volume.

In addition to the underlying futures contract, the designated option market may trade at chronically low levels or may cease to trade. Thus, the Commission proposed to include option contract markets under the requirement of Commission Rule 5.2 that designated contract markets in which no trading has occurred for all expiration months listed for trading for a period of six months shall be deemed dormant.[8] As the Commission previously noted, the rationale for applying the dormant contract rule to futures, *i.e.*, that contracts which have not traded may have outdated terms and conditions and that an opportunity to reassess those terms and conditions is necessary before trading can be resumed (47 FR 29515, 29517 (July 7, 1982)), is equally true with respect to option markets.[9]

Generally, those commenting opposed the delisting requirements where the underlying futures contract falls below the volume as specified. Commenters based their objections on the belief that there is no evidence to suggest that low futures volume by itself poses a problem or that the particular levels selected are arbitrary and unwarranted. The Commission does not agree with these views. Since the inception of the pilot program, the Commission has maintained the importance of approving options based on futures only where the underlying futures market has sufficient liquidity. The limitation on the number of contracts initially permitted under the pilot program and the provision for a three-year designation implicitly addressed this problem. The Commission firmly believes that with these two restrictions removed, it is necessary to assure that sufficiently liquid futures markets are the basis for option markets.

Some commenters argued that a dormant contract rule is unnecessary for options based on futures. These commenters argued that it is the underlying futures contract which will become out of date during a dormant period but that the terms of the option contract should not change over time. The Commission disagrees and believes that it is appropriate before trading is resumed in a dormant option contract to review its terms and conditions. Insofar as the option has fewer terms which may need to be changed than, for example, a futures contract specifying physical delivery, the Commission's review may be simpler and more expeditious.[10]

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[7] The Commission, pursuant to Commission Rule 32.4, additionally has authorized banks located in the United States to grant options on foreign currencies traded on the Montreal Exchange as principals for business-related purposes. 51 FR 12698 (April 15, 1986).

[8] In light of the prospective nature of these rule amendments, the six-month period for calculating whether a contract market is dormant begins on the effective date of this rule. Accordingly, no option contract market will be deemed to be "dormant" until at least six months following the effective date of the rule amendment. However, the three-year exemption period for newly designated contract markets is calculated from the date of designation and expires three years from that date. Thus, certain of the option contract markets which were designated in the early stages of the program no longer qualify under the exemption for newly designated markets.

[9] The Commission also proposed a technical amendment to Rule 5.2(c). This amendment deleted a procedure for expediting Commission approval of the proposal to resume trading under the dormant contract rule. The Commission believes that, in light of the statutory deadline for Commission review of exchange rule amendments enacted as part of the Futures Trading Act of 1982, such a separate time limit is unnecessary.

[10] In light of the fact that information regarding all commercial participants in the option markets is required to be provided by exchanges under Commission Rule 16.04, the Commission did not propose that chronically low volume option contracts be included under Commission Rule 5.3. However, contract markets are expected, as a matter of diligent self-regulation, to institute adequate surveillance procedures for all contract markets and to increase such efforts where appropriate.

E. Reporting Requirements

The Commission is adopting the amendments to Rule 16.01 as proposed. These amendments require that, where a delta factor is used by an exchange (including an exchange's clearing organization) for margining positions, evaluating compliance with speculative position limits, or evaluating the financial exposure of its members, the exchange report the delta factor to the Commission on a daily basis in marchine-readable form.

As the Commission explained in proposing its rules, such a requirement was not included in the initial option rules because delta systems were introduced by certain exchanges as the pilot program progressed. The use of deltas is important in the Commission's general surveillance of the markets, and the Commission should therefore know the particular delta factors used by the exchanges which trade options. Moreover, the Commission concluded that because such information was similar to that otherwise required under Rule 16.01 and is important to the financial operations of the option market, such information should be made available to the public in printed form on a daily basis.

The majority, but not all, of the commenters opposed this requirement. Typically the rationale of those opposing the requirements was that they agreed that the delta factors should be known to the Commission and the public-at-large at any particular time, but that the exchanges should be able to make available the delta formula to the Commission and the FCM community without undertaking to release the deltas on a daily basis. Thus, these commenters suggest that the Commission and the FCMs calculate the delta factors on their own.

The Commission believes that this alternative is not acceptable and that the better alternative is to require that the exchanges using delta factors make them available to both the Commission and the general public. There is a potential public impact if the exchanges use delta factors for any of the three reasons given above. It is not enough, however, to make public only the delta formulas. Results from the same delta formula may vary depending on interpretation or construction of the variables used in the formula and the particular methods of approximation used for solution. Moreover, solving the formula may require sophisticated methods beyond the means of many market participants. For this reason, public dissemination of the actual deltas used by the exchanges, rather than their methods of calculation, is appropriate. For the same reasons, it is appropriate that the exchanges provide the Commission with the calculated delta values. It is onerous and duplicative for the Commission and FCMs to attempt to develop and maintain various systems for calculating deltas which emulate those developed by the exchanges. It is necessary, however, for general surveillance, enforcement of speculative limits and of position-based capital requirements, and oversight of the exchanges' application of their financial rules that the Commission have access to the delta factors used by the exchanges.

The Commission also proposed two amendments to Rule 16.02. These proposed changes would provide the Commission and the exchanges with specific, additional information necessary for the conduct of market surveillance. They would require that reportable positions in each option expiration be reported by strike price. These data are currently provided only for the option which is next to expire or which will expire within six weeks. Also, for those exchanges which have adopted a delta system for purposes of exchange speculative position limits, the relevant position information would be provided in hard copy on a delta equivalent basis in a form and manner approved by the Director of the Division of Economic Analysis.

Although several commenters objected to these proposed rule amendments, two supported it. One, a large futures exchange, stated that it was already providing information in the form required by the proposed rule. The other commenter, a major FCM, noted that the proposed rule was a logical extension of the present requirement and that the cost and burden of providing the additional information was minimal. Two other commenters, both futures exchanges, objected to the requirement. One of those objecting stated that had the Commission originally requested the detail proposed now, the exchange could have avoided the costs associated with a change in the reporting requirements. The exchange also maintained that sufficient information was available from the current reports and that "the current report provides the Commission with position data on reportable positions for an overwhelming fraction of the total open interest in our contracts."

Although it is unfortunate that additional resources must be spent on various programming changes, it was the nature of the pilot program that after three years' experience certain changes were to be expected. Indeed, the very concept of a three-year pilot program was to provide a test of what would be required for permanent option trading. In this regard, it is unreasonable to assume that all details of the reports which the Commission would find necessary could have been known in advance of trading experience. Nevertheless, as indicated in these final rule amendments, the Commission has found it necessary to make few changes in its option rules at this time when the pilot status of the program is being terminated.

The reporting of option positions by expiration months to the exchanges is necessary, at the vary least, for the exchanges to enforce their option and futures speculative limits. Moreover, because of various exemptions permitted by the Commission, it is necessary that for applicable markets the exchanges transmit the position data in this form to the Commission in order for the Commission to enforce its speculative limits on futures or to oversee properly exchange enforcement of their speculative position limits and position-based capital requirements.

For example, during the course of the pilot option program, the Commission has approved exchange rules allowing certain exemptions from exchange option and futures speculative limits. Further, the Commission, at the request of the exchanges, has allowed certain exemptions from federal futures speculative limits based on offsetting option positions held in the same commodity. Commonly, these exemptions include certain option and futures configurations which are offsetting and generally include conversions and reverse conversions and, less typically, delta equivalent option to futures spreads. Calculation of these configurations requires knowledge of the option expiration months in which positions are held.

Under current rules, if the Commission notes a potential violation of its speculative limits or that of an exchange, it must contact the exchange to determine the expiration months in which option positions are held. This procedure can become burdensome, given the growth in options trading generally, and, more specifically, the number of traders who appear to avail themselves of these exemptions. Finally, it should be noted that if for particular contracts open interest is concentrated in the nearby months, as suggested by one commenter, there is little additional data that the exchanges must supply. Accordingly, the Commission is

adopting the amendments to Commission Rule 16.02 as proposed.

The Commission also proposed that the requirement that contract markets conduct market-wide surveys be deleted (Commission Rule 16.05) and that Commission Rule 21.02a be amended to require FCMs to respond to special calls in machine-readable form whether or not for purposes of sample surveys. As the Commission stated in its proposed rulemaking, it has not found it effective to use Commission Rule 16.05, which relies upon exchanges to conduct market-wide surveys. Rather, the Commission has itself conducted such surveys in order to ensure better the timeliness and standardization of the survey process. The Commission believes that the amendment of these two provisions results in no net increase of the information that FCMs are required to provide. In this connection, it should be noted that no commenters objected to these provisions. The Commission therefore adopted as final the proposed amendments to Commission Rules 21.02 and 21.02a as part of a final rulemaking or related reporting requirements (51 FR 4712 (February 7, 1986)) and is hereby deleting Commission Rule 16.05.

F. Changes in Sales Practice Requirements

The Commission also proposed to modify and streamline several of the special requirements that apply under the pilot program to the offer and sale of exchange-traded options. Although the comments received by the Commission generally favored each of the Commission's proposals, several of the commenters, noting the paucity of sales practice abuses during the past three years, also apparently assumed that the termination of option trading's pilot status meant that the Commission could eliminate altogether the special safeguards that have been one of the principal features of the pilot program.

The Commission does not agree, however, that the absence of sales practice problems during the course of the pilot program is evidence that the option sales practice rules are unnecessary. On the contrary, the Commission more prudently assumes that the absence of significant sales practice problems is itself evidence of the effectiveness of the sales practice rules which were adopted by the Commission as a cornerstone of the pilot program. Indeed, and as the Commission made clear at that time, those rules were adopted by the Commission after careful consideration and in light of the Commission's prior experience with the trading of options other than on designated contract markets during the early and mid-1970s. *See* 46 FR 54500, 54502–03 (November 3, 1981).

The Commission has nonetheless been willing to make appropriate modifications to those rules in light of its experience with option trading under the pilot program. The Commission therefore contemplates that it will continue to evaluate these requirements as it gains additional information with respect to public, "retail" participation in the option markets, even after the termination of the "pilot" status of option trading. The Commission notes, however, that it would expect not to diminish significantly existing option sales practice standards. Rather, the Commission anticipates that continued refinements in *futures* sales practice standards, such as those that have already been adopted by industry self-regulatory organizations in the years since the inception of the pilot program, should ultimately allow the Commission to harmonize and unify futures and option sales practice regulation.

With respect to the specific items proposed by the Commission, the commenters uniformly supported the proposed amendments to Commission regulations 33.4 (b)(4), (b)(6), and (b)(8) which would eliminate certain repetitious filings currently required of FCMs which are members of more than one self-regulatory organization. Those proposals, which are being adopted by the Commission without change, will relieve FCMs of the burden of filing copies of customer complaints, promotional material, and notices of disciplinary action with every self-regulatory organization of which the FCM happens to be a member. Those materials will now instead be filed routinely only with an FCM's designated self-regulatory organization which, as before, will have primary responsibility for monitoring it members' option sales practices.

The Commission has similarly determined that it is no longer necessary to continue to require FCMs and introducing brokers ("IBs") to reduce to writing and file with the exchanges and the National Futures Association any oral customer complaint which could result in an adjustment to a customer's account of $1000 or more. As the Commission noted when it proposed this latter amendment, there has been little evidence of oral complaints. Of greater practical significance, the Commission expects that a customer complaint, at least of the type contemplated by the rule, would most likely be in writing. Continued retention of this aspect of regulations 33.4(b)(4) therefore appears to be unnecessary.

By comparison, the Commission cannot agree with the suggestion made by one of the commenters that the proscription against (and duty to audit for evidence of) "high-pressure sales communications" be eliminated from Commission regulations 33.4(b)(10) and (c). Although the offer and sale of exchange-traded options generally has not be tainted by the types of practices that characterized commodity options prior to the establishment of the pilot program, the Commission must, as noted above, assume that this record is evidence of the need for standards and requirements such as the ban on high-pressure sales tactics. Indeed, the Commission believes that an effective program for the prevention of sales practice abuses would always include procriptions against high-pressure sales tactics.

The Commission is making several clarifying changes in the provisions governing the oral and written disclosures that must be made to option customers. In particular, the Commission has determined to adopt the proposed amendment to that portion of the disclosure rule which requires FCMs and introducing brokers to provide a "description" of the futures contract physical commodity underlying a particular option. As the Commission observed when it proposed this change to § 33.7(b)(2), this requirement has been construed to require FCMs and IBs to provide to every customer a comprehensive listing of every option contract that has been designated by the Commission. These listings typically provide the details not only of the option contracts themselves and of the futures contract or physical commodity underlying those options, but subsequent amendments to any of the terms and conditions of those contracts as well. The Commission noted that such required disclosures are not likely to be of more than incidental interest to option customers, that all of this information is readily available upon request, and that compliance with this requirement appears to entail substantial operational difficulties for FCMs and IBs.

The Commission therefore proposed to require instead that FCMs and IBs identify the futures contract or physical commodity which may be purchased or sold upon exercise of an option or, if applicable, whether exercise of the option will be settled in cash. Those persons who commented on this aspect of the Commission's proposal uniformly supported this change. In particular, the

commenters stated that the existing rule was burdensome and, for the reasons identified by the Commission in its proposal, apparently unnecessary. The commenters further observed that the rule as amended would nonetheless ensure that customers continue to receive any information of which they should be aware. The Commission is, therefore, adopting this portion of its proposal without change.

Commenters did not favor the Commission's proposed modifications regarding limit moves and the overnight risk of positions which have been exercised. They maintained that such disclosures were unnecessary or might further confuse customers. The Commission is unpersuaded by these comments and is of the opinion that such disclosures provide the public with additional information concerning the risks of option trading. Accordingly, the Commission is adopting the modifications without change.

The Commission is aware that the foregoing amendments to § 33.7 will require the modification of the Options Disclosure Statement that is provided to perspective option customers by future commission merchants and introducing brokers. The Commission further recognizes that FCMs or IBs may have an inventory of such Disclosure Statements in the form currently specified by Commission regulation 33.7. The Commission has therefore determined to allow FCMs and IBs to continue to use any such existing Disclosure Statements for up to six months from the date of publication of this Federal Register notice and will not take any enforcement action with respect to the distribution, during that time, of a Disclosure Statement that has not been amended to reflect the changes to Commission regulation 33.7(b) that are today being adopted by the Commission.

One of the commenters suggested that the Commission also reconsider the oral disclosures that must, under its rules, be made prior to every option transaction. In particular, while Commission regulation 33.7(c) currently requires that certain essential information be provided to option customers prior to the entry of the *first* transaction for the account of an option customer, Commission regulation 33.7(d) requires other information—such as commissions, fees, and exercise charges—to be repeated prior to *every* option transaction. The Commission agrees that reiteration of all of this information prior to every transaction is not likely to be of significant value to customers and may, in fact, impede the prompt transmission and execution of customer orders.

The Commission has, therefore, modified this portion of its regulations to require that certain basic information be provided to option customers prior to the first option transaction. Specifically, information relating to commissions, costs, fees and other charges to be incurred in connection with an option transaction (including any costs associated with exercise of the option) must now be provided in advance of the first option transaction but will not have to be reiterated unless that information has become inaccurate. Other items, such as the option strike price and premium, which are an integral part of each trade must, of course, continue to be disclosed to an option customer (other than a discretionary account customer) prior to each transaction.[11]

This commenter further observed that Commission regulation 33.7(b)(2)—which comprises a portion of the required Options Disclosure Statement—could similarly be construed to require repetitive disclosures, not only of commissions, costs and fees, but also of numerous other items of information. In particular, § 33.7(b)(2) specifies that an FCM or IB "is required to provide, and the individual contemplating an option transaction should obtain, a description" of various items (such as exercise procedures, storage charges, and margin requirements) that are alluded to in that portion of the Disclosure Statement "[p]rior to entering into *any* transaction involving a commodity option." (Emphasis added.) The commenter therefore urged the Commission to amend the Disclosure Statement to eliminate any such requirement.

The Commission has not previously interpreted § 33.7(b)(2), however, to require that these various items be disclosed affirmatively before each trade (except to the extent that they are covered by the separate provisions of regulation 33.7(d), discussed above). Rather, the Commission contemplates that an FCM or IB will provide its customers with all of the information required under the Option Disclosure Statement prior to the entry of the first transaction, as required by § 33.7(c). Thereafter, and as discussed above, § 33.7(d) will require an FCM or IB routinely to provide only that information (such as strike price and premium) which is related to a specific transaction unless additional disclosures are necessary to keep current any of the information that has previously been provided.[12]

[11] The Commission has also deleted the requirement, formerly contained in § 33.7(c), that the limitations, if any, on the transfer of an option customer's account from one future commission merchant to another be provided in writing. This provision was originally proposed in response to perceived problems in non-domestic markets (42 FR 55538, 55546 (October 17, 1977)); to the extent this issue has any continued relevance to trading under the pilot program, the Commission believes that the underlying problem is adequately addressed by rules of the various self-regulatory organizations.

III. Related Matters

A. The Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601 et. seq., requires that agencies, in proposing rules, consider the impact of these rules on small businesses. The Commission has previously determined that contract markets are not "small entities" for purposes of the FRA. 47 FR 18618 (April 30, 1982). These proposed rules would permit and govern the trading of options on various contract markets and therefore, if promulgated, would not have significant economic impact on a substantial number of small entities. Accordingly, for the above reason and pursuant to section 3(a) of the Regulatory Flexibility Act, 5 U.S.C. 605(b), the Chairman, on behalf of the Commission, certifies that these regulations will not have a significant economic impact on a substantial number of small entities. However, the Commission invited comments from any firms or other persons which believed that the promulgation of these rule amendments might have a significant impact upon their activities. No such comments were received.

B. Paperwork Reduction Act

The Commission has submitted to the Director of the Office of Management and Budget (OMB) pursuant to the provisions of the Paperwork Reduction Act (44 U.S.C. Chapter 35), an explanation and details of the information collections required under these rules. A copy of this Federal

[12] An FCM or IB continues to remain obligated, under Commission Rule 33.7(f), to "disclose all material information to existing or prospective option customers even if the information is not specifically required" by the Commission's option disclosure rule. Furthermore, and as the Commission has previously indicated, an FCM or IB must additionally acquaint itself sufficiently with the personal circumstances of each option customer to determine what further facts, explanations and disclosures are needed in order for that particular option customer to make an informed decision whether to trade options. The procedures to be followed by the prudent FCM or IB in ascertaining those personal circumstances may require an FCM or IB to make an inquiry into an option customer's sophistication for purposes of determining to what extent risk disclosure above and beyond the disclosure statement itself might be advisable. 45 FR 54500, 54507 (November 3, 1981).

Register notice is also being sent to OMB. These rules amend existing rules which have been assigned OMB control numbers 3038–0007, 3038–0012, and 3038–0022. In response to the Commission's invitation for comments (50 FR 35255), several commenters questioned certain of the proposed amendments to the reporting requirements. The Commission has considered these comments carefully and has discussed them in detail above.

List of Subjects in 17 CFR Part 33

Commodity exchange, Commodity exchange designation procedures, Commodity exchange rules, Commodity futures, Commodity options, Customer protection, Contract markets, Dormant Contracts Disclosure requirements, Financial rules, Fraud, Hedging, Reporting and recordkeeping requirements.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act and in particular, sections 2(a)(1)(A), 4c(b), 4c(c), 4c(d), 5, 5a, 6 and 8a thereof, 7 U.S.C. 2, 4, 6c(a), 6c(b) 6c(c), 6c(d), 7, 7a, 8 and 12a, the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for Part 1 is revised to read as follows:

Authority: 7 U.S.C. 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 7, 7a, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 19, 21, 23, and 24 unless otherwise noted.

2. Section 1.3 is amended by revising paragraph (z)(1) introductory text, (z)(1)(iii), and the undesignated text at the end of (z)(1) to read as follows:

§ 1.3 Definitions.

* * * * *

(z) *Bona fide hedging transactions and positions.*

(1) *General definition.* Bona fide hedging transactions and positions shall mean transactions or positions in a contract for future delivery on any contract market, or in a commodity option, where such transaction or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and where they arise from:

* * * * *

(iii) The potential change in the value of services which a person provides, purchases, or anticipates providing or purchasing.

Notwithstanding the foregoing, no transactions or positions shall be classified as bona fide hedging unless their purpose is to offset price risks incidental to commercial cash or spot operations and such positions are established and liquidated in an orderly manner in accordance with sound commercial practices and, for transactions or positions on contract markets subject to trading and position limits in effect pursuant to section 4a of the Act, unless the provisions of paragraphs (z) (2) and (3) of this section and §§ 1.47 and 1.48 of the regulations have been satisfied.

* * * * *

3. Section 1.46 is amended by revising paragraph (d)(1) to read as follows:

§ 1.46 Application and closing out of offsetting long and short positions.

* * * * *

(d) * * *

(1) Purchases or sales of commodity options constituting "bona fide hedging transactions" pursuant to rules of the contract market which have been adopted in accordance with the requirements of § 1.61(b) and approved by the Commission pursuant to Section 5a(12) of the Act; *Provided,* that no contract market or futures commission merchant shall permit such option positions to be offset other than by open and competitive execution in the trading pit or ring provided by the contract market, during the regular hours prescribed by the contract market for trading in such commodity option.

* * * * *

4. Section 1.61 is amended by revising paragraphs (b)(2) and (c) to read as follows:

§ 1.61 Speculative position limits.

* * * * *

(b) * * *

(2) No bylaw, rule, regulation or resolution adopted pursuant to paragraph (b)(1) of this section shall apply to positions held by commercial interests in the underlying commodity which are determined by a contract market to be bona fide hedging positions as defined by a contract market in accordance with § 1.3(z)(1) of this chapter; *Provided,* that the contract market may limit bona fide hedging positions which it determines are not in accord with sound commercial practices or exceed an amount which may be established and liquidated in an orderly fashion.

(c) *Time of filing.* Boards of trade seeking designation as a contract market in options or futures shall submit rules, bylaws, regulations or resolutions pursuant to this section with their application for designation.

* * * * *

PART 5—DESIGNATION OF AND CONTINUING COMPLIANCE BY CONTRACT MARKETS

5. The authority citation for Part 5 is revised to read as follows:

Authority: 7 U.S.C. 6c, 7, 7a, 8 and 12a, unless otherwise noted.

6. Section 5.2 is revised to read as follows:

§ 5.2 Dormant contracts.

(a) *Definitions.* For purposes of this section:

(1) The term "dormant contract market" means any commodity futures or option contract market:

(i) In which no trading has occurred in any future or option expiration for a period of six complete calendar months; or

(ii) Which has been certified by a board of trade to the Commission to be a dormant contract market.

(b) *Listing of additional futures trading months of option expirations.* No dormant contract market may list additional months or expirations for trading, or otherwise permit trading to recommence in such a dormant contract market, until such time as the Commission approves, pursuant to section 5a(12) of the Act and § 1.41(b) of these regulations, the bylaw, rule, regulation or resolution of the contract market submitted to the Commission pursuant to paragraph (c) of this section.

(c) *Bylaw, rule, regulation or resolution to list additional trading months or expirations.* (1) Any bylaw, rule, regulation or resolution of a contract market to list additional trading months or expirations in a dormant contract market or to otherwise recommence trading in such a contract market shall be submitted to the Commission under Section 5a(12) of the Act and § 1.41(b) of these regulations.

(2) Each submission shall include the information required to be submitted pursuant to § 1.41(b) of these regulations and also shall:

(i) Clearly designate the submission as filed pursuant to Commission Rule 5.2.

(ii) Contain an economic justification for the listing of additional months or expirations in the dormant contract market, which shall include an explanation of those economic conditions which have changed subsequent to the time the contract became dormant and an explanation of how any new terms and conditions

which are now being proposed by the contract market, or which have been proposed for an option market's underlying futures contract market, would make it reasonable to expect that the futures or option contract will be used on more than an occasional basis for hedging or price basing.

(d) *Exemptions.* No contract market shall be considered dormant until the end of thirty-six (36) complete calendar months:

(1) Following designation;

(2) Following notice to the contract market that the Commission has reviewed the economic purpose and the terms and conditions of the contract and has determined in its discretion to permit this exemption; or

(3) Following Commission approval of the contract market bylaw, rule, regulation, or resolution submitted pursuant to paragraph (c) of this section.

7. Part 5 is amended by adding a new § 5.4 to read as follows:

§ 5.4 Delisting criteria for options.

For options on a designated futures contract market, where the trading volume of the underlying futures contract market falls below an average of 1,000 contracts per week for all trading months listed during the preceding six month period, no new expiration months may be listed for trading. New expiration months may be added in accordance with rules of the contract market when trading volume in the underlying designated futures contract market rises above an average of 2,000 contacts per week for all trading months listed for a period of three consecutive months.

PART 16—REPORTS BY CONTRACTS MARKETS

8. The authority citation for Part 16 is revised to read as follows:

Authority: 7 U.S.C. 6a, 6c, 6g, 6i, 7, and 12a, unless otherwise noted.

9. Section 16.01 is amended by revising paragraphs (a) (5) and (a) (6,) adding (a)(7), and revising the undersignated text at the end of (a) to read as follows:

§ 16.01 Trading volume, open contracts and prices.

(a) * * *

(5) The total number of option contracts exercised;

(6) The total number of option contracts that expired unexercised; and

(7) The option delta, where a delta system is used.

This information shall be made readily available to the new media and the general public in printed form and without charge at the office and trading floor of the contract market no later than the business day following the day for which publication is made.

* * * * *

10. Section 16.02 is amended by revising paragraphs (a) introductory text, (a)(1)(i) (A), (B) and (C), removing (a)(1)(i)(D) and (E), revising (a)(1)(ii) (A) through (D), and by adding paragraph (a)(1) (iv) to read as follows:

§ 16.02 Large option trader reports.

(a) *Information required.* Each contract market shall submit to the Commission a weekly report for options on futures and for options on physicals that are settled in cash and, unless otherwise determined by the Commission, a daily report on all other options on physicals, containing the following information for each option trader controlling a reportable option position.

(1)(i) * * *

(A) All reportable position by expiration month and by strike price;

(B) The total reportable position controlled by the option trader by expiration month, regardless of strike prices; and

(C) The total reportable position controlled by the option trader in all option expiration dates, regardless of strike prices.

(ii) * * *

(A) All reportable positions by expiration month and by strike price;

(B) The total reportable position controlled by the option trader by expiration month regardless of strike prices;

(C) The total reportable position controlled by the option trader in all option expiration dates, regardless of strike prices; and

(D) The number of contracts exercised.

* * * * *

(iv) For those option contract markets which have adopted an option delta system for purposes of enforcing exchange speculative position limits pursuant to § 1.61 of this chapter, the information required by paragraph (a) of this section shall also be submitted in hard copy form on a delta-equivalent basis in a form and manner approved by the Director of the Division of Economic Analysis.

* * * * *

11. Part 16 is amended by removing and reserving § 16.05.

PART 33—REGULATION OF DOMESTIC EXCHANGE-TRADED COMMODITY OPTION TRANSACTIONS

12. The authority citation for Part 33 continues to read as follows:

Authority: 7 U.S.C. 2, 2a, 4, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 7, 7a, 7b, 8, 9, 11, 12a, 12c, 13a, 13a–1, 13b, 19 and 21 unless otherwise noted.

13. Section 33.4 is amended by removing and reserving paragraph (a)(5)(ii), revising paragraphs (a)(5)(iii) and (a)(6)(ii), removing and reserving paragraph (b)(2), and revising paragraphs (b)(4) introductory text, (b)(4)(i), (b)(4)(iii), (b)(6) and (b)(8) to read as follows:

§ 33.4 Designation as a contract market for the trading of commodity options.

* * * * *

(a) * * *

(5) * * *

(ii) [Reserved]

(iii) For opotions on futures contracts, the volume of trading in all contract months for future delivery of the commodity for which the option designation is sought has averaged at least 3,000 contracts per week on such futures contract market for the 12 months preceding the date of application for option contract market designation, or alternatively, that such futures contract market, based on its trading history, substantially meets this total volume requirement in less than 12 months preceding the date of application; and

* * * * *

(6) * * *

(ii) For commodities not specifically enumerated in section 2(a)(1)(A) of the Act, is not designated as a contract market for more than one other option on a physical

* * * * *

(b) * * *

(2) [Reserved]

* * * * *

(4) Require, with respect to all written option customer complaints, that each member futures commission merchant which engages in the offer or sale of commodity options regulated under this Part:

(i) Retain all such complaints;

* * * * *

(iii) Immediately send a copy of any such complaint to the member's designated self-regulatory organization and, upon final disposition thereof, immediately send a copy of the record of such disposition to the member's designated self-regulatory organization.

* * * * *

(6) Require each member futures commission merchant which engages in the offer or sale of option contracts regulated under this Part to give to the member's designated self-regulatory organization notice of any disciplinary

action taken against the futures commission merchant or any of its associated persons by the Commission or by another self-regulatory organization.

* * * * *

(8) Require each member futures commission merchant which engages in the offer or sale of option contracts regulated under this Part promptly to submit to the member's designated self-regulatory organization all promotional material (as defined in § 33.1). Such promotional material must be promptly reviewed by the designated self-regulatory organization to determine that such material is not fraudulent.

* * * * *

15. Section 33.5 is amended by revising paragraph (c) to read as follows:

§ 33.5 Application for designation as a contract market for the trading of commodity options.

* * * * *

(c) For options on a futures contract on a commodity specifically enumerated in section 2(a)(1)(A) of the Act, the effective period for designation as a contract market for a particular commodity option under this Part shall be for a period not to exceed three years from the effective date of the designation, or such shorter period as the Commission may specify at the time the designation is granted, and in any event shall be of no further force or effect should the Commission, by rule or regulation, repeal the provisions of this Part under which such designation is granted. Except as may be specifically authorized by the Commission, no board of trade which has been designated as a contract market for the trading of commodity options may authorize or allow the trading of any commodity option which will expire after the termination of the effective period of such designation or where the delivery month of the futures contract underlying such option is later than the termination of the effective period of such designation or where the delivery month for the underlying futures contract has not been listed.

16. Section 33.7 is amended by revising paragraphs (b)(2) introductory text and (b)(2)(i), by removing paragraph (b)(2)(ii) and by redesignating paragraph (b)(2)(iii)-(b)(2)(viii) as paragraphs (b)(2)(ii)-(b)(2)(vii), and by revising paragraphs (b)(3), (b)(5), (c), and (d) to read as follows:

§ 33.7 Disclosure.

* * * * *

(b) * * *

(2) *Description of commodity options.* Prior to entering into any transaction involving a commodity option, an individual should thoroughly understand the nature and type of option involved and the underlying futures contract or physical commodity. The futures commission merchant or introducing broker is required to provide, and the individual contemplating an option transaction should obtain:

(i) An identification of the futures contract or physical commodity underlying the option and which may be purchased or sold upon exercise of the option or, if applicable, whether exercise of the option will be settled in cash;

* * * * *

(3) *The mechanics of option trading.* Before entering into any exchange-traded option transaction, an individual should obtain a description of how commodity options are traded.

Option customers should clearly understand that there is no guarantee that option positions may be offset by either a closing purchase or closing sale transaction on an exchange. In this circumstance, option grantors could be subject to the full risk of their positions until the option position expires, and the purchaser of a profitable option might have to exercise the option to realize a profit.

For an option on a futures contract, an individual should clearly understand the relationship between exchange rules governing option transactions and exchange rules governing the underlying futures contract. For example, an individual should understand what action, if any, the exchange will take in the option market if trading in the underlying futures market is restricted or the futures prices have made a "limit move."

The individual should understand that the option may not be subject to daily price fluctuation limits while the underlying futures may have such limits, and, as a result, normal pricing relationships between options and the underlying future may not exist when the future is trading at its price limit. Also, underlying futures positions resulting from exercise of options may not be capable of being offset if the underlying future is at a price limit.

* * * * *

(5) *Profit potential of an option position.* An option customer should carefully calculate the price which the underlying futures contract or underlying physical commodity would have to reach for the option position to become profitable. This price would include the amount by which the underlying futures contract or underlying physical commodity would have to rise above or fall below the strike price to cover the sum of the premium and all other costs incurred in entering into and exercising or closing (offsetting) the commodity option position.

Also, an option customer should be aware of the risk that the futures price prevailing at the opening of the next trading day may be substantially different from the futures price which prevailed when the option was exercised. Similarly, for options on physicals that are cash settled, the physicals price prevailing at the time the option is exercised may differ substantially from the cash settlement price that is determined at a later time. Thus, if a customer does not cover the position against the possibility of underlying commodity price change, the realized price upon option exercise may differ substantially from that which existed at the time of exercise.

* * * * *

(c) Prior to the entry of the first commodity option transaction for the account of an option customer, a futures commission merchant or an introducing broker, or the person soliciting or accepting the order therefor, must provide an option customer with all of the information required under the disclosure statement, including the commissions, costs, fees and other charges to be incurred in connection with the commodity option transaction and all costs to be incurred by the option customer if the commodity option is exercised: *Provided,* That the futures commission merchant or the introducing broker, or the person soliciting or accepting the order therefor, must provide current information to an option customer if information provided previously has become inaccurate.

(d) Prior to the entry into a commodity option transaction on or subject to the rules of a contract market, each option customer or prospective option customer shall, to the extent the following amounts are known or can reasonably be approximated, be informed by the person soliciting or accepting the order therefor of the amount of the strike price and the premium (and any mark-ups thereon, if applicable).

* * * * *

Issued in Washington, DC on May 7, 1986, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 86-10736 Filed 5-12-86; 8:45 am]

BILLING CODE 6351-01-M

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

21 CFR Part 1308

Schedules of Controlled Substances: Rescheduling of Synthetic Dronabinol in Sesame Oil and Encapsulated in Soft Gelatin Capsules From Schedule I to Schedule II; Statement of Policy

AGENCY: Drug Enforcement Administration, Justice.

ACTION: Final Rule and Statement of Policy.

SUMMARY: This final rule is issued by the Administrator of the Drug Enforcement Administration (DEA) to transfer U.S. Food and Drug Administration (FDA) approved drug products that consist of synthetic dronabinol in sesame oil encapsulated in soft gelatin capsules from Schedule I into Schedule II of the Controlled Substances Act (CSA). Dronabinol is the synthetic equivalent of the isomer of delta-9-tetrahydrocannabinol (THC) which is the principal psychoactive substance in *Cannabis sativa L.*, marijuana. This action is based on a finding that U.S. Food and Drug Administration approved drug products which contain dronabinol fit the statutory criteria for inclusion in Schedule II of the CSA. As a result of this rule, the regulatory controls and criminal sanctions of Schedule II of the CSA will apply to the manufacture, distribution, importation and exportation of dronabinol pharmaceutical products. This rule does not affect the Schedule I status of any other substance, mixture or preparation which is currently included in 21 CFR 1308.11(d)(21), Tetrahydrocannabinols. The Administrator herein also issues a statement of policy regarding review, under the public interest criteria of 21 U.S.C. 823(f) and 824(a)(4), of the DEA registrations of practitioners who distribute or dispense dronabinol for purposes at variance with the FDA approved indications for use of the approved product. A notice is published elsewhere in this isue of the **Federal Register** that withdraws the proposed rule entitled Changes in Protocol Requirements for Researchers and Prescription Requirements for Practitioners (50 FR 42184–42186, October 18, 1985).

EFFECTIVE DATE: May 13, 1986.

FOR FURTHER INFORMATION CONTACT: Howard McClain, Jr., Chief, Drug Control Section, Office of Diversion Control, Drug Enforcement Administration, Washington, DC 20537. Telephone: (202) 633–1366.

SUPPLEMENTARY INFORMATION:

List of Subjects in 21 CFR Part 1308

Administrative practice and procedure, Drug traffic control, Narcotics, Prescription drugs.

A proposed rule was published in the **Federal Register** on October 18, 1985 (50 FR 42186–42187), proposing that dronabinol in sesame oil and encapsulated in soft gelatin capsules in a drug product approved by the U.S. Food and Drug Administration be transferred from Schedule I to Schedule II of the Controlled Substances Act (21 U.S.C. 801 et seq.). Concurrently, a proposal was published which proposed changes in protocol requirements for researchers and prescription requirements for practitioners (50 FR 42184–42186). Interested persons were given until November 18, 1985, to submit comments or objections regarding each of the proposals.

Thirteen individuals or organizations availed themselves of the opportunity to comment, object or request an administrative hearing. Two organizations, Cannabis Corporation of America and National Organization for the Reform of Marijuana Laws (NORML), requested hearings. Both requests for hearings were subsequently withdrawn. Comments or objections were submitted by or on behalf of the following: Alliance for Cannabis Therapeutics, American College of Neuropsychopharmacology, American Medical Association, American Pharmaceutical Association, Arkansas Department of Health, Committee on Problems of Drug Dependence, Inc., Mr. Ansis M. Helmanis, the law offices of Kleinfeld, Kaplan and Becker, Marcos A. S. Lima, M.D., H. G. Pars Pharmaceutical Laboratories and the Pharmaceutical Manufacturers Association.

Having considered the comments and objections presented by the above listed parties, the requirements of the Controlled Substances Act and the Convention on Psychotropic Substances (T.I.A.S. 9725, July 15, 1980), the Administrator has decided (a) to proceed with the rescheduling of dronabinol as proposed at 50 FR 42186–42187 and (b) to issue a statement of policy regarding review of the distribution or dispensing of dronabinol by practitioner registrants which deviates from approved medical use to insure compliance with the obligations of the United States as a signatory to the Convention on Psychotropic Substances. The previously proposed regulations relating to dronabinol are withdrawn elsewhere in this issue of the **Federal Register**.

(a) Transfer of FDA Approved Dronabinol Drug Products From Schedule I to Schedule II

Having considered the comments and objections presented by the above listed parties and based on the investigations and review of the Drug Enforcement Administration, with attention to the obligations of the United States under the Convention on Psychotropic Substances, and relying on the scientific and medical evaluation and recommendation of the Assistant Secretary for Health of the Department of Health and Human Services, acting on behalf of the Secretary of the Department of Health and Human Services, in accordance with 21 U.S.C. 811(b), and the Food and Drug Administration approval of a new drug application for Marinol capsules, the Administrator of the Drug Enforcement Administration, pursuant to the provisions of 21 U.S.C. 811(a), finds that:

1. Dronabinol (synthetic) in sesame oil and encapsulated in soft gelatin capsules in a U.S. Food and Drug Administration approved drug product has a high potential for abuse;

2. Dronabinol (synthetic) in sesame oil and encapsulated in soft gelatin capsules in a U.S. Food and Drug Administration approved drug product has a currently accepted medical use in treatment in the United States or a currently accepted medical use with severe restrictions, and

3. Dronabinol (synthetic) in sesame oil and encapsulated in soft gelatin capsules in a U.S. Food and Drug Administration approved drug product may lead to severe psychological or physical dependence.

The above findings are consistent with placement of dronabinol approved drug products into Schedule II of the CSA. The transfer of the product from Schedule I to Schedule II is effective on May 13, 1986 with selected implementation dates as indicated. In the event that this imposes special hardships on any registrant, the Drug Enforcement Administration will entertain any justified request for an extention of time to comply with the Schedule II regulations. The applicable regulations are as follows:

1. *Registration.* Any person who manufactures, distributes, delivers, imports or exports a FDA approved dronabinol drug product, or who engages in research or conducts instructional activities with such a substance must be registered to conduct such activities in accordance with Parts

1301 and 1311 of Title 21 of the Code of Federal Regulations. Any person currently registered to handle dronabinol in Schedule I may continue activities under that registration until approved or denied registration in Schedule II, provided such registrant has filed an application for registration in Schedule II with DEA on or before June 12, 1986. Any persons not currently registered and proposing to engage in such activities may not conduct activities with the drug product until properly registered in Schedule II.

2. *Security.* FDA approved dronabinol drug products must be manufactured, distributed and stored in accordance with §§ 1301.71, 1301.72(a), (c) and (d), 1301.73, 1301.74, 1301.75(b) and (c) and § 1301.76 of Title 21 of the Code of Federal Regulations. Dronabinol and all mixtures, compounds and preparations thereof, except for dronabinol in sesame oil and encapsulated in soft gelatin capsules in a FDA approved drug product, remain in Schedule I and must be stored in accordance with § 1301.75(a).

3. *Labeling and Packaging.* All labels and labeling for commercial containers of FDA approved dronabinol drug products must comply with the requirements of §§ 1302.03–1302.05 and 1302.07–1302.08 of Title 21 of the Code of Federal Regulations. Current products distributed or dispensed for approved research and labeled as Schedule I products may continue to be distributed and dispensed until May 13, 1987.

4. *Quotas.* All persons required to obtain quotas for dronabinol drug products shall submit applications pursuant to §§ 1303.12 and 1303.22 of Title 21 of the Code of Federal Regulations.

5. *Inventory.* Every registrant required to keep records and who possesses any quantity of FDA approved dronabinol drug product shall take an inventory, pursuant to § 1304.04 and §§ 1304.11–1304.19 of Title 21 of the Code of Federal Regulations, of all stocks on hand as of June 12, 1986.

6. *Records.* All registrants required to keep records pursuant to §§ 1304.21–1304.27 of Title 21 of the Code of Federal Regulations shall do so regarding FDA approved dronabinol drug products.

7. *Reports.* All registrants required to submit reports pursuant to §§ 1304.34–1304.37 of Title 21 of the Code of Federal Regulations shall do so regarding FDA approved dronabinol drug products.

8. *Order Forms.* All registrants involved in the distribution of dronabinol drug products shall comply with the order form requirements of Part 1305 of Title 21 of the Code of Federal Regulations.

9. *Prescriptions.* FDA approved dronabinol drug products have been approved for use in medical treatment and the drug may be dispensed by prescription. All prescriptions for FDA approved dronabinol drug products shall comply with §§ 1306.01–1306.06 and §§ 1306.11–1306.15 of Title 21 of the Code of Federal Regulations.

10. *Importation and Exportation.* All importation and exportation of dronabinol drug products shall be in compliance with Parts 1311 and 1312 of Title 21 of the Code of Federal Regulations.

11. *Criminal Liability.* Any activity with respect to FDA approved dronabinol drug products not authorized by or in violation of the Controlled Substances Act or the Controlled Substances Import and Export Act continues to be unlawful. The applicable penalties after May 13, 1986 shall be those of a Schedule II substance.

12. *Other.* In all other respects, this order is effective on May 13, 1986.

(b) Statement of Policy

The Administrator takes special note of the fact that synthetic tetrahydrocannabinol in all forms, including dronabinol, remains internationally controlled in Schedule I of the Convention on Psychotropic Substances. Under the special obligations of the Convention, to which the United States is a party, relative to Schedule I substances, Article 7 requires in part that parties shall "prohibit all use except for scientific and *very limited medical purposes . . .*" (emphasis added). The Administrator also notes that the official "Commentary on the Convention on Psychotropic Substances" provides guidance to parties in meeting this obligation consistent with national laws and policies.

The Administrator finds that the existing requirements of Schedule II of the Controlled Substances Act can provide adequate controls and restrictions to comply with the obligations of the Convention on Psychotropic Substances when coupled with effective oversight and enforcement, such as provided for in the Dangerous Drug Diversion Control Act of 1984 (part B of chapter V of Title II of Pub. L. 98–473). The Administrator notes that experience has demonstrated that there are medical practitioners registered to dispense Schedule II substance who abuse that registration and prescribe or dispense Schedule II substances outside the scope of the legitimate medical practice.

On May 31, 1985, the Food and Drug Administration (FDA) approved the drug product, Marinol capsules, containing dronabinol for nausea associated with cancer treatment. Considering the nature of this drug, it is reasonable to assume that drug abusers will attempt to seek out practitioner registrants willing to prescribe the drug for abuse purposes, under the guise of legitimate medical practice, as frequently occurs with other Schedule II substances. DEA has encountered practitioners who attempt to justify illegal or improper distribution or dispensing by claiming unique knowledge of a drug's effectiveness for a broad range of medical indications. While it is expected that legitimate structured research programs may document additional medical indications for dronabinol, prescribing which deviates from the recognized approved medical use must be questioned in keeping with the United States obligations to prohibit all use except for scientific and very limited medical purposes.

Therefore, in keeping with sound domestic drug control policy and the United States obligations under the Convention on Psychotropic Substances, the Administrator hereby issues this statement of policy:

Any person registered by DEA to distribute, prescribe, administer or dispense controlled substances in Schedule II who engages in the distribution or dispensing of dronabinol for medical indications outside the approved use associated with cancer treatment, except within the confines of a structured and recognized research program, may subject his or her controlled substances registration to review under the provisions of 21 U.S.C. 823(f) and 824(a)(4) as being inconsistent with the public interest. DEA will take action to revoke that registration if it is found that such distribution or dispensing constitutes a threat to the public health and safety, and in addition will pursue any criminal sanctions which may be warranted under 21 U.S.C. 841(a)(1). See *United States* v. *Moore*, 423 U.S. 122 (1975).

The proposed rule which was published at 50 FR 42184–42186, October 18, 1985, entitled Changes in Protocol Requirements for Researchers and Prescription Requirements for Practitioners, is withdrawn elsewhere in this issue of the Federal Register.

Pursuant to sections 3(c)(3) and 3(e)(2)(C) of Executive Order 12291 (46

FR 13193), this statement of policy has been submitted for review by the Office of Management and Budget. In accordance with the provisions of 21 U.S.C. 811(a), this order to reschedule certain drug products which contain synthetic dronabinol from Schedule I to Schedule II is a formal rulemaking "on the record after opportunity for a hearing." Such proceedings are conducted pursuant to the provisions of 5 U.S.C. 556 and 557 and as such have been exempted from the consultation requirements of Executive Order 12291.

Pursuant to 5 U.S.C. 605(b), the Administrator certifies that the rescheduling of formulations which contain dronabinol, as ordered herein, will not have a significant impact upon small businesses or other entities whose interests must be considered under the Regulatory Flexibility Act (Pub. L. 96–354, September 19, 1980). This action will allow the marketing of a drug product which has been approved by the FDA.

Pursuant to the authority vested in the Attorney General by section 201(a) of the CSA [21 U.S.C. 811(a)], as redelegated to the Administrator of the Drug Enforcement Administration by 28 CFR 0.100, and for the reasons set forth above, the Administrator hereby orders that 21 CFR 1308.12 be amended as follows:

PART 1308—[AMENDED]

1. The authority citation for 21 CFR Part 1308 continues to read as follows:

Authority: 21 U.S.C. 811, 812, 871(b).

2. 21 CFR 1308.12 is amended by redesignating the existing paragraph (f) as paragraph (g) and by adding a new paragraph (f), reading as follows:

§ 1308.12 Schedule II.

* * * * *

(f) *Hallucinogenic substances.*

(1) Dronabinol (synthetic) in sesame oil and encapsulated in a soft gelatin capsule in a U.S. Food and Drug Administration approved drug product..... 7369

[Some other names for dronabinol: (6a*R-trans*)-6a,7,8,10a-tetrahydro-6,6,9-trimethyl-3-pentyl-6*H*-dibenzo[*b,d*]pyran-1-ol, or (-)-delta-9-(trans)-tetrahydrocannabinol]

* * * * *

Dated: May 1, 1986.

John C. Lawn,

Administrator, Drug Enforcement Administration.

[FR Doc. 86–10724 Filed 5–12–86; 8:45 am]

BILLING CODE 4410–09–M

DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

30 CFR Part 914

Approval of Permanent Program Amendments From the State of Indiana Under the Surface Mining Control and Reclamation Act of 1977

AGENCY: Office of Surface Mining Reclamation and Enforcement (OSMRE), Interior.

ACTION: Final rule.

SUMMARY: OSMRE is announcing the appproval of amendments to the Indiana Permanent Regulatory Program (hereinafter referred to as the Indiana program) received by OSMRE pursuant to the Surface Mining Control and Reclamation Act of 1977 (SMCRA).

On January 31, 1986, Indiana submitted amendments to its program requirements regarding civil penalties, incidental boundary revisions and use of explosives.

After providing opportunity for public comment and conducting a thorough review of the program amendments, the Director, OSMRE, has determined that the amendments meet the requirements of SMCRA and the Federal regulations. Accordingly, the Director is approving these amendments. The Federal rules at 30 Part 914 which codify decisions concerning the Indiana program are being amended to implement this action.

This final rule is being made effective immediately in order to expedite the State program amendment process and encourage States to conform their programs to the Federal standards without undue delay; consistency of the State and Federal standards is required by SMCRA.

EFFECTIVE DATE: May 13, 1986

FOR FURTHER INFORMATION CONTACT: Mr. Richard D. Rieke, Director, Indianapolis Field Office, Office of Surface Mining Reclamation and Enforcement, Federal Building and U.S. Courthouse, Room 522, 46 East Ohio Street, Indianapolis, Indiana 46204. Telephone: (317) 269–2600.

SUPPLEMENTARY INFORMATION:

I. Background

Information regarding the general background on the Indiana State program, including the Secretary's findings, the disposition of comments and a detailed explanation of the conditions of approval of the Indiana program can be found in the July 26, 1982 **Federal Register** (47 FR 32071–32108). Subsequent actions concerning the Indiana program are identified in 30 CFR 914.15 and 30 CFR 914.16.

II. Discussion of Proposed Amendment

On January 31, 1986, the Indiana Department of Natural Resources submitted to OSMRE pursuant to 30 CFR 732.17, proposed State program amendments for approval (Administrative Record No. IND 0453). The amendments modify requirements for civil penalty assessments, incidental boundary revisions and use of explosives.

OSMRE published a notice in the **Federal Register** on February 26, 1986, announcing receipt of the proposed program amendments and procedures for the public comment period and for requesting a public hearing on the substantive adequacy of the proposed amendments (51 FR 6751). The public comment period ended March 28, 1986. There was no request for a public hearing and the hearing scheduled for March 24, 1986, was not held.

III. Director's Findings

The Director finds, in accordance with SMCRA and 30 CFR 732.15 and 732.17, that the program amendments submitted by Indiana on January 31, 1986, meet the requirements of SMCRA and 30 CFR Chapter VII. Only those areas of particular interest are discussed below in the specific findings. Discussion of only those provisions for which findings are made does not imply any deficiency in any provisions not discussed.

Civil Penalties

Indiana has amended 310 IAC 12–6–11 to provide that the regulatory authority shall assess a penalty for a violation which leads to a cessation order and for notices of violation assigned 31 points or more under the point system established in 310 IAC 12–6–12.5. The rule provides that the regulatory authority may assess a penalty for 30 points or less. Under the rule, a penalty of $5000 per day shall be assessed for mining without a permit, except under certain circumstances.

Indiana has amended 310 IAC 12–6–12 to establish the requirements for assigning points for penalties based on certain factors. The factors to be considered are: The permittee's history of violations at the particular operation (up to 30 points); the seriousness of the violation for which the penalty is being assessed (up to 15 points); the degree of the permittee's negligence or fault in the violation (up to 25 points); and degree of good faith determined from the permittee's efforts to abate the violation (up to negative 30 points).